

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200907013**  
Release Date: 2/13/2009

Third Party Communication: None  
Date of Communication: Not Applicable  
Person To Contact:

Index Number: 355.00-00, 355.01-01, 368.00-00, 368.04-00

, ID No.  
Telephone Number:

Refer Reply To:  
CC:CORP:06  
PLR-128251-08  
Date:  
October 30, 2008

Legend:

Distributing =

Controlled 1 =

Controlled 2 =

State A =

Date 1 =

Group A

Group B =

Group C =

a =

b =

c =

d =

e =

f =

Business 1 =

Business 2 =

Business 3 =

Dear :

This letter responds to your representative's June 17, 2008 request for rulings on certain federal income tax consequences of a series of proposed transactions. The information submitted in that letter and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the proposed transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation, the controlled corporations, or both (see § 355(a)(1)(B) of the Internal Revenue Code (the "Code") and § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty percent or greater interest in the distributing corporation or either of the controlled corporations (see § 355(e) and § 1.355-7).

### Summary of Facts

Distributing is a closely held State A corporation that was incorporated on Date 1. Distributing's capital structure consists of voting common stock, a shares of which are outstanding, and non-voting common stock, b shares of which are outstanding. Distributing is owned by three family shareholder groups. The outstanding shares are held in equal proportions by the three family groups (Group A, Group B, and Group C),

each of which owns c shares of voting common stock and d shares of non-voting common stock.

Distributing is engaged in Business 1, Business 2, and Business 3. Distributing has submitted financial information which indicates that Business 1, Business 2 and Business 3 have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

### **Proposed Transaction**

For what are represented as valid business reasons, Distributing proposes the following transactions (the "Proposed Transaction"):

1. Controlled 1 and Controlled 2 will be incorporated by Distributing in State A. Each controlled corporation will have one class of voting common stock, with e shares outstanding, and one class of non-voting common stock, with f shares outstanding.
2. Distributing will transfer the Business 2 Assets and liabilities to Controlled 1 in exchange for all of the Controlled 1 stock ("Contribution 1").
3. Distributing will transfer the Business 3 Assets and liabilities to Controlled 2 in exchange for all of the Controlled 2 stock ("Contribution 2"). Contribution 1 and Contribution 2 are sometimes collectively referred to as the "Contributions".
4. Immediately after the Contributions, Distributing will distribute all of the Controlled 1 stock to the Group B shareholders in exchange for all of their Distributing stock and will distribute all of the Controlled 2 stock to the Group C shareholders in exchange for all of their Distributing stock (the "Distribution"). Thereafter, the Group A shareholders will own all of the Distributing stock, the Group B shareholders will own all of the Controlled 1 stock, and the Group C shareholders will own all of the Controlled 2 stock. Distributing, Controlled 1 and Controlled 2 will be accrual basis taxpayers.

### **Representations**

The following representations have been made with respect to the Proposed Transaction:

- a) Distributing, Controlled 1, Controlled 2, and each of their respective shareholders will pay their own expenses incurred in connection with the transaction.
- b) The indebtedness owed by Controlled 1 or Controlled 2 to Distributing after the distribution, if any, will not constitute stock or securities.

- c) The fair market value of the Controlled 1 stock received by the shareholders of Group B will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange; and the fair market value of the Controlled 2 stock received by the shareholders of Group C will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.
- d) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- e) The five years of financial information submitted on behalf of Business 1 conducted by Distributing is representative of its present business operations, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- f) The five years of financial information submitted on behalf of Business 2 to be transferred to Controlled 1 is representative of its present business operations, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- g) The five years of financial information submitted on behalf of Business 3 to be transferred to Controlled 2 is representative of its present business operations, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- h) Following the transaction, Distributing, Controlled 1, and Controlled 2 will each continue the active conduct of their respective businesses, independently and with their separate employees.
- i) The distribution of the stock of Controlled 1 and Controlled 2 will be carried out for the following corporate business purposes: (i) to enhance the success of the three businesses by enabling the corporations to resolve management problems that have arisen and been exacerbated by Distributing's operation of different businesses; and (ii) to allow each of the shareholder groups to concentrate on a single business. The distributions of the stock of Controlled 1 and Controlled 2 are motivated, in whole or substantial part, by one or more of these corporate business purposes.
- j) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1 or Controlled 2.

- k) The total adjusted basis and the fair market value of the assets transferred to each Controlled corporation by Distributing each will equal or exceed the sum of (i) the liabilities assumed (within the meaning of § 357(d)) by each Controlled corporation, and (ii) the total of any money and the fair market value of any property (within the meaning of § 361(b)) transferred by each controlled corporation to Distributing that is to be distributed to the shareholders of Distributing or transferred to the creditors of Distributing pursuant to the plan of reorganization.
- l) The aggregate fair market value of the assets Distributing transfers to each controlled corporation in the Contributions will equal or exceed the aggregate adjusted basis of these assets.
- m) The liabilities to be assumed (within the meaning of § 357(d)) by Controlled 1 and Controlled 2 in the transaction, if any, and the liabilities to which the transferred assets are subject, if any, were incurred in the ordinary course of business and are associated with the assets being transferred.
- n) The fair market value of the assets of each controlled corporation will exceed the amount of its liabilities immediately after the exchange.
- o) The income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
- p) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- q) Except for short-term accounts payable created in the ordinary course of business with respect to transactions based on terms and conditions arrived at by the parties bargaining at arm's length, no intercorporate debt will exist between Distributing, Controlled 1 and Controlled 2 at the time of, or subsequent to, the distribution of the stock of Controlled 1 and Controlled 2.
- r) Payments made in connection with all continuing transactions, if any, between Distributing, Controlled 1 and Controlled 2, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- s) No parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

- t) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50-percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- u) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of Controlled 1 stock entitled to vote, or 50-percent or more of the total value of shares of all classes of Controlled 1 stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- v) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of Controlled 2 stock entitled to vote, or 50-percent or more of the total value of shares of all classes of Controlled 2 stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- w) The distributions are not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of § 355(d)(4)) in Distributing, Controlled 1, or Controlled 2 (including any predecessor or successor of any such corporation).
- x) Immediately after the distributions, neither Distributing, Controlled 1, nor Controlled 2 will be a disqualified investment corporation (within the meaning of § 355(g)(2)).

### **Rulings**

Based solely on information submitted and the representations set forth above, we rule as follows:

(1) The transfer by Distributing to Controlled 1 of part of its assets in exchange for all of the Controlled 1 stock and assumption of liabilities followed by the distribution of all the Controlled 1 stock to the Group B shareholders in exchange for all of their Distributing stock will constitute a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled 1 each will be “a party to a reorganization” within the meaning of § 368(b).

(2) The transfer by Distributing to Controlled 2 of part of its assets in exchange for all of the Controlled 2 stock and assumption of liabilities followed by the distribution of all the Controlled 2 stock to the Group C shareholders in exchange for all of their Distributing stock will constitute a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled 2 each will be “a party to a reorganization” within the meaning of § 368(b).

(3) Distributing will recognize no gain or loss upon the transfer of assets to Controlled 1 in exchange for Controlled 1 stock and the assumption of liabilities and upon the transfer of assets to Controlled 2 in exchange for Controlled 2 stock and the assumption of liabilities (§§ 361(a) and 357(a)).

(4) Controlled 1 and Controlled 2 each will recognize no gain or loss on the receipt of assets in exchange for their respective Controlled stock and the assumption of liabilities (§ 1032(a)).

(5) Controlled 1's basis in each asset received from Distributing and Controlled 2's basis in each asset received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).

(6) Controlled 1's holding period of each asset received from Distributing and Controlled 2's holding period of each asset received from Distributing will include the period during which Distributing held such asset (§1223(2)).

(7) The Group B shareholders and Group C shareholders will recognize no gain or loss (and no amount will otherwise be included in the income of either the Group B shareholders or the Group C shareholders) upon receipt of the Controlled 1 and Controlled 2 stock, respectively, in exchange for all of their Distributing stock (§ 355(a)).

(8) Distributing will recognize no gain or loss on the distribution of the Controlled 1 stock to the Group B shareholders and the Controlled 2 stock to the Group C shareholders (§ 361(c)).

(9) The aggregate basis of the Controlled 1 stock in the hands of the Group B shareholders and the Controlled 2 stock in the hands of the Group C shareholders will

equal the aggregate basis of the Distributing stock each respectively surrendered in the exchange (§ 358(a)).

(10) The Group B shareholders' holding period of the Controlled 1 stock and the Group C shareholders' holding period of the Controlled 2 stock received in the distribution will include each shareholder's respective holding period of the Distributing stock respectively surrendered in the distribution, provided that the Distributing stock is held as a capital asset on the date of the distribution (§ 1223(1)).

(11) Distributing's earnings and profits will be allocated between Distributing and Controlled 1 and between Distributing and Controlled 2 in accordance with § 312(h) and § 1.312-10(a).

### **Caveats**

No opinion is expressed about the tax treatment of the Proposed Transaction described above under other provisions of the Code and regulations or the tax treatment of any condition existing at the time of, or effects resulting from, the Proposed Transaction that is not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the Proposed Transaction satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Proposed Transaction is used principally as a device for the distribution of the earnings and profits of the distributing corporation, the controlled corporations, or both (see § 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Proposed Transaction is part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii).

### **Procedural Statements**

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.



In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

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Richard M. Heinecke  
Assistant to the Branch Chief, Branch 6  
(Corporate)

cc: